

**Limitations of the
Automated Non-Masterfile
and the
Impact on the Internal Revenue Service**

September 1999

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 3, 1999

MEMORANDUM FOR COMMISSIONER ROSSOTTI

A handwritten signature in black ink that reads "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Limitations of the Automated
Non-Masterfile and the Impact on the Internal Revenue
Service

This report presents the results of our review of the Internal Revenue Service (IRS) processing of transactions and taxpayer accounts on the Automated Non-Masterfile (ANMF) system.

In summary, transactions were accurately input to the ANMF and to the IRS accounting system. However, inherent processing problems exist that have resulted in the IRS not being compliant with the Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996), and taxpayer accounts containing inaccurate penalty and interest calculations. Many of the accounts on the ANMF are old, including 220 accounts over 20 years old. Also, processing inefficiencies and errors have resulted in undue taxpayer burden, increased operating costs, and lost revenue.

The Chief Operations Officer concurred with the findings and recommendations and has agreed to take corrective action. Management's response has been incorporated into the body of the report where appropriate, and the full text of management's response is included as an appendix to this report.

These corrective actions, however, are a short-term solution to the problems facing the ANMF. Until the IRS makes changes to allow the processing of ANMF transactions on the Masterfile and consolidates the 10 existing ANMF systems, the limitations of the ANMF will continue to have an impact on the ability of the IRS to provide effective and efficient service to taxpayers with accounts on the ANMF.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have any questions, or your staff may call Walter Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs), at (770) 455-2478.

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Executive Summary

The Internal Revenue Service (IRS) uses a computer system known as the Automated Non-Masterfile (ANMF) to process those tax returns and transactions that cannot be processed on its primary computer system known as the Masterfile. Each of the 10 IRS service centers has a separate ANMF database that is not connected with any other service center's ANMF or other IRS computer system. These separate databases, as well as other limitations of the ANMF, have resulted in inaccurate balances in taxpayers' accounts and the IRS not being compliant with the Taxpayer Bill of Rights 2, Pub. L. No. 104-168, Stat. 1452 (1996). (All future references to this law will be to the law in general and will be noted as "TBOR2.")

Many of the 101,216 accounts on the ANMF as of September 30, 1997, are old, including 220 accounts totaling over \$234 million that are over 20 years old. Processing inefficiencies and errors have also resulted in undue taxpayer burden, increased operating costs, and lost revenue. The problems identified in this report are primarily the result of the ANMF being a system that requires manual input and processing actions. Until the IRS makes changes to allow the processing of ANMF accounts on the Masterfile and consolidates the 10 existing ANMF systems, additional efforts are needed to more efficiently process Non-Masterfile (NMF) transactions and maintain taxpayer accounts.

Results

IRS employees accurately input the original documents received in the NMF units to the ANMF and to the accounting system. However, because of inherent processing and account maintenance problems:

The Internal Revenue Service Needs to Correct Inaccuracies in Interest and Penalty Computations and Evaluate the Validity of Old Accounts

The ANMF contains inaccurate data on taxpayer accounts and maintains old accounts. Our analysis of the ANMF showed that 6,700 balance due accounts exceeding \$750 million with tax, interest, penalties, and accruals are over 10 years old. The IRS also needs to correct inaccuracies in interest and penalty computations that were caused either by errors in the design of the program used to calculate the failure to pay assessed tax amounts or errors in the original processing of interest and penalty assessments.

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The Internal Revenue Service Has Not Issued Reminder Notices to Taxpayers With Delinquent Automated Non-Masterfile Accounts in Violation of Taxpayer Bill of Rights 2

The Congress passed TBOR2 in July 1996 to provide increased protection for taxpayers. Two years later, the IRS still has not issued required annual reminder notices to taxpayers with delinquent accounts on the ANMF. The IRS previously canceled the issuance of notices because of concerns that both taxpayer addresses and account information were not correct. The IRS initially planned to issue notices only to taxpayers whose balance due accounts were determined to be Currently Not Collectible (CNC), but collection activity had been suspended. However, the Forms and Submission Processing and Collection Division management agreed with our interpretation of TBOR2 that, in addition to CNC accounts, notices should also be sent to taxpayers with certain other types of balance due accounts.

The Non-Masterfile Process Contains Inefficient Manual Procedures

Freeze codes were not always input to taxpayer accounts to prevent the automatic issuance of incorrect refunds on related Masterfile accounts. Additionally, the IRS has not always complied with the legal requirement to issue information returns (Form 1099-INT) to taxpayers that the IRS paid more than \$10 in interest.

Recently, the IRS began to address some of the ANMF issues. A study completed in February 1998 made 13 recommendations to improve customer service and processing efficiency. Many of these recommendations were scheduled to be implemented in January 1999. However, because of limited computer resources and other priorities, some of the recommendations, such as consolidating the ANMFs, putting ANMF accounts on other computer systems, and modifying computer programs, will be delayed or may not be as effective as originally intended.

The Commissioner's modernization concept includes the goal to provide service to all taxpayers. This goal cannot be effectively accomplished for those taxpayers with accounts on the ANMF until the IRS corrects the limitations leading to the inaccuracies and inefficiencies associated with the ANMF.

Summary of Recommendations

The IRS should expedite changes to allow the processing of ANMF accounts on the Masterfile and to consolidate the existing NMFs. Until those actions are completed, the IRS should take the following actions to improve accounts maintenance:

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- Establish a working group to validate the accuracy of interest and penalty programming on the ANMF, make necessary programming changes, and program the ANMF to accrue penalty and interest on credit balance cases.
- Identify short-term and long-term solutions to ensure the timely and accurate issuance of TBOR2 notices. This should include reviewing and correcting existing accounts on the ANMF to ensure taxpayers receive accurate and appropriate notices, as required by TBOR2.
- Establish more effective procedures to ensure credit balance cases are timely worked, transaction codes are input to prevent incorrect refunds on related Masterfile accounts, and Forms 1099-INT are issued when taxpayers receive interest of more than \$10 from the IRS.

Management's Response: The Chief Operations Officer concurred with the findings and recommendations. The IRS prepared six requests for new computer programs to correct errors in penalty and interest computations, identify and update ANMF address changes, and freeze the refund on Masterfile accounts where there is a related ANMF liability. The IRS also plans to review and correct old ANMF accounts in order to issue TBOR2 notices.

Office of Audit Comment: These corrective actions are a short-term solution to the problems facing the ANMF. The limitations of the ANMF will continue to have an impact on the IRS' ability to provide effective and efficient service to taxpayers with accounts on the ANMF. In addition, we are concerned that some of the proposed corrective actions may not be adequate. For example:

- The corrections in the IRS' computer program were designed to correct the penalty and interest errors identified by this audit and by the NMF task force. Our audit was not designed to identify all situations where calculations may be incorrect. We remain concerned that there are other situations of incorrect interest and penalty calculations that have not been identified.
- The IRS elected not to implement a computer program to correct the refund freeze code problems for business accounts on the Masterfile, citing programming difficulties and a low volume of cases. Instead they replied that the initiator continues to have the responsibility to direct the input of the freeze code. It is because of the multiple number of initiators and functional responsibilities that the freeze codes were not input. We continue to believe this process should be centralized, or review procedures should be implemented, to ensure the freeze code is input if required at the time the ANMF account is established.

Objectives and Scope

We initiated this audit of the Automated Non-Masterfile (ANMF) as part of a national strategy to evaluate service center accounting operations. We reviewed documents processed in all 10 Internal Revenue Service (IRS) service centers. We conducted limited tests in the National Office and the Kansas City, Austin, and Fresno Service Centers. We performed audit work between December 1997 and June 1998 in accordance with *Government Auditing Standards*. The management response was not received until April 1, 1999, because additional time was needed to address the issues in this report.

Our objectives were to determine if Non-Masterfile transactions are accurately recorded on the ANMF, are reconciled to the IRS accounting system, and could be processed on the Masterfile.

Our overall objectives were to determine if:

1. Transactions are accurately recorded on the ANMF and in the IRS accounting system.
2. Accounts on the ANMF are balanced and reconciled to the IRS accounting system.
3. Transactions on the ANMF could be processed on the Masterfile.

Appendix I lists the detailed objectives, scope and methodology of this review. Appendix II lists the major contributors to this report.

Background

Most tax returns and taxpayer accounts are processed and maintained on a computer system known as the Masterfile. There is a Masterfile for individual accounts (IMF) and one for business accounts (BMF).

However, the Masterfile is currently not programmed to process certain types of accounts. The IRS processes these accounts on the Automated Non-Masterfile (ANMF). Some examples include employee pension plan assessments, certain excise taxes, and accounts originally on the Masterfile as a joint entity with an

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action taken that affects only one spouse. The ANMF is also used to process transactions that either exceed the allowable number of transactions or dollar value limit on a Masterfile account, and those impacted by new tax laws for which timely programming changes could not be made to the Masterfile.

The ANMF is a local database maintained by each of the 10 IRS service centers. They do not connect with each other. The ANMF also does not interface with either the IRS accounting system or other computer systems.

During the first 9 months of Fiscal Year (FY) 1997, the IRS processed about 190,000 documents involving 507,000 transactions to the ANMF. As of September 30, 1997, the ANMF contained 101,216 balance due accounts with over \$9.8 billion in assessed tax, interest, and penalties. These accounts contained an additional \$4.2 billion of accumulated (commonly referred to as accrued) interest and penalties. The IRS suspended collection activity on about 53,000 accounts totaling \$6 billion that had been reported as uncollectible.

Results

IRS employees accurately input original documents to the ANMF and to the IRS accounting system.

Overall, IRS employees accurately input the original documents received in the Non-Masterfile (NMF) units to the ANMF and to the accounting system. We randomly selected and reviewed 278 of 190,000 documents and identified 5 documents with errors. We also reviewed the first 82 of these 278 documents and determined the transaction amounts were accurately and timely input to the accounting system. In addition, where documentation was available, we determined that all transactions were input to the correct revenue or assessment account. NMF transactions are also timely and properly reconciled between the ANMF and the accounting system.

Inherent processing problems exist on the ANMF.

However, inherent processing problems exist on the ANMF that have resulted in taxpayers' accounts containing inaccurate penalty and interest calculations and the IRS not being compliant with the Taxpayer Bill

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of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996). (All future references to this law will be to the law in general and will be noted as “TBOR2.”) In addition, processing inefficiencies and errors have resulted in undue taxpayer burden, increased operating costs, and lost revenue. These problems primarily result from the ANMF being a manually driven system that requires manual input and processing actions.

Recently, the IRS began to address some of the ANMF issues.

Recently, the IRS began to address some of the ANMF issues. In December 1997, the IRS initiated a study of the ANMF to develop short-term resolutions to problems. This study was finalized in February 1998 and resulted in 13 recommendations. The IRS also established a steering committee to address solutions to long-term ANMF problems, such as moving individual and employee plan accounts to the Masterfile.

However, due to the uncertainties of the Year 2000 computer changes, legislative requirements, and limited computer programming resources, the IRS does not plan to move accounts to the Masterfile without further studying the issue. As of September 30, 1997, about 85 percent of the ANMF accounts receivable were individual and employee plan taxpayers.

The IRS should expedite changes to the Masterfile and consolidate the existing NMFs.

Based on the current use of the ANMF and the need to maintain some type of backup system to Masterfile, we believe there is a need for the ANMF. However, the IRS should expedite changes to allow the processing of ANMF accounts on the Masterfile and consolidate the existing NMFs to improve the efficiency and accuracy of processing.

Our review of the ANMF identified the following issues:

- The IRS needs to correct inaccuracies in interest and penalty computations and evaluate the validity of old accounts.
- The IRS has not issued reminder notices to taxpayers with delinquent ANMF accounts in violation of the TBOR2.

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- The NMF process contains inefficient manual procedures.

The Internal Revenue Service Needs to Correct Inaccuracies in Interest and Penalty Computations and Evaluate the Validity of Old Accounts

Although the service center accounting staffs correctly input transactions to the ANMF, we identified instances of inaccurate and extremely old accounts on the ANMF. For example:

- Interest and penalty computations are not always accurate.
- Credit balance accounts do not reflect accrued penalties and interest.
- The ANMF contains many old accounts.

Interest and penalty computations are not always accurate

We reviewed interest and penalty assessments on 159 of 278 cases. Although the audit was not designed to identify all instances of incorrect interest and penalty computations, this audit identified seven conditions that caused the assessed balance or accruals of penalty and interest to be incorrect. Details of the different types of errors are in Appendix IV.

Inaccurate penalty computations resulted from errors in the design of the program and in the manual calculation of penalty and interest assessments.

Several cases involved inaccurate penalty computations resulting from errors in the design of the program used to calculate the failure to pay assessed tax amounts. In addition, we identified errors in the manual calculation of interest and penalty assessments.

The February 1998 task force report listed 10 conditions in which the ANMF system cannot compute correctly. Several of the situations we identified that resulted in incorrect interest or penalties are included in the task force report.

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The automated system was not designed to calculate accrued interest and penalties in all situations.

The NMF was originally designed as a manual system. This manual system was automated in 1991. However, the automated system was not designed to calculate accrued interest and penalties in all situations. Also, it was not until 1997 that changes were made to calculate accrued interest and penalties, which was done to provide accounts receivable information.

Incorrect computations and assessments of tax, interest, or penalty could result in either loss of revenue to the government or excess charges to taxpayers. If the ANMF system cannot accurately calculate interest and penalty, balance due notices will have to be manually prepared.

Credit balance accounts do not reflect accrued penalties and interest

The ANMF does not compute accrued penalties and interest when accounts are in a credit balance.

The ANMF does not accrue penalties and interest when accounts are in a credit balance. The ANMF generates a notice to the NMF unit when an account goes to a credit balance. The NMF unit must manually review these accounts to determine if the taxpayer is due a refund or if additional penalties and interest should be assessed. The ANMF generates another notice to the NMF unit after 26 weeks, and after 1 year, a notice is issued weekly.

In some cases, taxpayers with credit balances actually owe money.

The NMF units may not be timely working credit balance cases. Our review of 278 of 190,000 cases included 12 cases with credit balances. Five of the 12 cases have been in a credit balance between 6 and 9 months, and 7 cases have been in a credit balance less than 6 months. In 4 of the 12 cases, the taxpayers actually owe between \$200 and \$16,000 as a result of accrued interest and penalties that were not assessed. As of May 15, 1998, the ANMF was comprised of about 121,000 accounts. Of these accounts, 2,359 were credit balance accounts.

The failure to timely work credit balance cases can result in lost revenue and additional taxpayer burden. The taxpayer may also incur additional interest expenses or may not receive a timely refund.

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The ANMF contains many old accounts

*Over 6,700 NMF accounts
(7 percent) are over 10 years
old.*

Many of the accounts on the ANMF have been in existence for many years. Of the 101,216 NMF accounts as of September 30, 1997, over 6,700 were over 10 years old. We identified 38 accounts that were over 35 years old. Because of the age of these accounts, most of the total balance due consists of penalties and interest. An analysis of accounts 10 years or older identified:

<u>Age of Account in Years</u>	<u>Number of Cases</u>	<u>Assessed Tax</u>	<u>Total Tax, Interest, & Penalties including Accruals</u>
10 to 15	6,041	\$66,833,812	\$444,815,653
15 to 20	497	7,003,184	71,354,044
20 to 25	123	5,114,797	106,220,067
25 to 30	34	1,208,525	41,310,781
30 to 35	25	3,071,711	82,786,229
Over 35	<u>38</u>	<u>111,342</u>	<u>3,741,407</u>
Total	6,758	\$83,343,371	\$750,228,181

Source: Audit analysis of NMF Accounts Receivable as of September 30, 1997.

Due to the age of these accounts, documentation to support the assessment or extension of the statute of limitations may not be available. In one case, an original U. S. Individual Income Tax Return (Form 1040) **was assessed in the 1950's**, for about \$800. The account was reported Currently Not Collectible (CNC) one year later. There was no activity for almost 20 years, when the statute of limitations for collection was extended to December 1999.

The IRS has since offset the taxpayer's refunds to the ANMF during four of the last seven years. In June 1997, the IRS assessed about \$8,000 in accrued interest and penalties. As of March 31, 1998, the account shows a balance due of about \$8,000 plus over \$700 in additional accrued interest.

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Recommendations

1. Establish a group of programmers, NMF personnel, and other individuals knowledgeable on interest and penalties. This group should identify conditions in which the ANMF system incorrectly calculates interest and penalties, integrate these issues with Year 2000 code development and testing, and:
 - Make programming changes to correct the inaccuracies to the extent possible.
 - Mark those ANMF accounts that require manual computations.
2. Program the ANMF to accrue penalty and interest on credit balance cases, or establish procedures to manually assess accrued penalty and interest when an account reaches a credit balance.
3. Review and correct existing accounts on the ANMF. This should include:
 - A resolution of credit balance accounts to assess accrued interest and penalties where appropriate.
 - An analysis of old accounts to determine the validity of the assessment and statute of limitations.

Management's Response: A task force was established to identify conditions where the ANMF incorrectly calculates penalty and interest and a request for a computer program change was submitted to correct the computation of penalty and interest. In addition, a new exception code "M" will be used to mark accounts that require a manual computation. The Submission Processing function took additional measures to ensure accuracy in the computation of penalty and interest by conducting a training workshop for NMF technicians. The Program Analysis System is also reviewing NMF notices for accuracy of manual penalty and interest computations. In addition, the duties of a newly created Account Specialist position include the coordination of quality assurance reviews to ensure the accuracy of

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penalty and interest computations before the transfer to the ANMF.

Internal Revenue Manual (IRM) procedures were changed to specifically require the assessment of all accrued penalty and interest on ANMF credit balance accounts and before establishment on the NMF database. An additional enhancement generates a weekly Credit Balance Account listing as a management tool to ensure timely disposition of credit balance accounts.

All service center directors were notified to conduct a review of all ANMF accounts that are less than 11 years old. Agreement was also reached among the Forms and Submission Processing, Collection, Customer Service, Examination, and Appeals functions on the details for a review of “aged” (currently 11 years or greater) ANMF accounts. A cross-functional task group has also been convened to review a statistically valid sample of NMF accounts, determine the workability of the review process, provide a suggested structure to the review process, and expand procedures as required. Another detailed cross-functional review will be performed on all NMF accounts before issuance of the TBOR2 annual notices of delinquency.

Office of Audit Comment: The corrections in the IRS’ computer program were designed to correct the penalty and interest errors identified by this audit and by the NMF task force. Our audit was not designed to identify all situations where calculations may be incorrect. We remain concerned that there are other situations of incorrect interest and penalty calculations that have not been identified.

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**The Internal Revenue Service Has Not Issued
Reminder Notices to Taxpayers With
Delinquent Automated Non-Masterfile Accounts
in Violation of the Taxpayer Bill of Rights 2**

The IRS has not issued annual reminder notices to taxpayers with delinquent ANMF accounts. This is a violation of TBOR2.

The Congress passed TBOR2 in July 1996. One provision requires the IRS to send annual reminder notices to taxpayers with delinquent tax accounts beginning in 1997. The reason for this request is that the IRS generally pursues collection on larger deficiencies first. Cases with smaller deficiencies may not be addressed for years. In the meantime, the taxpayer may believe the lack of contact means the IRS does not intend to collect taxes owed or that they may not owe the tax.

Taxpayers may be surprised when the IRS resumes collection action years later when the 10-year statute of limitations on collections is close to expiring. During this time, the taxpayer's account will have accrued additional penalties and interest.

As of September 30, 1997, there were 101,216 balance due NMF accounts with over \$9.8 billion in assessed tax, interest, and penalties. These accounts contain an additional \$4.2 billion of accrued interest and penalties.

The IRS initially planned to issue notices during the last quarter of 1997, but canceled them because of concerns that the ANMF taxpayer address was not current and accrued interest and penalties were not correct.

Many of these accounts are old and taxpayer addresses are not routinely updated.

Many of these accounts are old and taxpayer addresses are not routinely updated. Therefore, issuing the notices to the address on the NMF could have resulted in a large number of undeliverable notices and required substantial time to research for new addresses. In addition, those notices that were deliverable could have caused

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numerous taxpayer inquiries and complaints about the accuracy of interest and penalties.

The IRS is taking steps to correct these problems. In February 1998, a NMF Study Group issued a report to address these issues. One recommendation was to create a computer program to identify differences between the ANMF account mailing address and the address on the Masterfile account. The report also stated the ANMF cannot be programmed to correctly compute penalty and interest in all cases. The report recommended the manual review and recomputation of all notices, if necessary, to determine the correct balance.

Additional issues should be evaluated prior to issuance of TBOR2 notices.

The IRS currently plans to issue the TBOR2 notices sometime in 1999. Although the IRS is evaluating recommendations to correct ANMF inaccuracies, additional actions should be evaluated prior to the issuance of the TBOR2 notices. Our review identified several issues that should be considered as part of the TBOR2 decision-making process. The following issues will have an impact on the number and accuracy of the notices to be issued:

Interest and penalties are not always correct. As previously mentioned, the systemic problems with calculating interest and penalty will require many manual computations. This will also lend itself to additional errors in the notices.

Some taxpayers with credit balance accounts may not receive notices. As previously reported, the existing ANMF program does not compute accrued penalties and interest when the account has a credit balance. As a result, taxpayers owe money will not receive a notice as required by law.

Initially, the IRS planned to issue reminder notices only to taxpayers whose accounts had been classified as not collectible.

Notices should be issued on other delinquent NMF accounts. Initially the IRS planned to issue reminder notices only to the 53,000 taxpayers whose accounts were considered uncollectible as of September 30, 1997. Our interpretation of TBOR2 was that the notice should be issued to certain other taxpayers with a balance due. The Forms and Submission Processing and Collection

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Divisions now plan to issue notices on these other delinquent accounts.

However, a tentative plan is to have the Collection Division issue notices on these other delinquent accounts using the Integrated Data Retrieval System (IDRS). IDRS is a computer system that gives employees access to taxpayer accounts. We believe this will create more confusion and potential erroneous notices for the following reasons:

- NMF delinquent accounts are stored on IDRS for reference purposes. However, interest and penalties must be manually computed.
- Using two different computer systems as the source could result in either multiple or no notices being issued, if each system generates the notices at different times.
- Even using commercial software, Collection Division personnel may not be sufficiently trained to process NMF accounts.

Recommendations

4. Conduct a computer match prior to issuing TBOR2 notices, as recommended by the NMF Study Group, of addresses on the Masterfile to addresses on the ANMF, and timely update the ANMF with the most recent address.
5. Issue notices to comply with the TBOR2 using the same criteria for issuing TBOR2 notices on Masterfile accounts. Issue all notices from the ANMF.

Management's Response: Two requests for computer programs were submitted. One program will generate a notice when the Masterfile address of an account with a related NMF account is changed January 1, 1999, or later. The other program will identify all address updates input prior to January 1, 1999, for any Masterfile account with an unreversed freeze code. This

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will generate a transcript for a manual update of the NMF address.

The IRS plans to begin generating the annual reminder notice in the second quarter of calendar year 1999, consistent with Masterfile criteria.

The Non-Masterfile Process Contains Inefficient Manual Procedures

The ANMF requires manual input and time-consuming processing actions.

Although the ANMF automated many of the processes associated with processing ANMF documents, it is still a manually driven system that requires manual input and time-consuming processing actions. In some instances, lack of staffing, other priorities, and human error result in some of these actions not being taken. For example:

- Freeze codes to prevent erroneous refunds are not always input on related Masterfile accounts.
- Information returns (Form 1099-INT) for interest paid on NMF accounts are not always prepared.
- Transfers of accounts from the Masterfile to and between NMFs are inefficient.

Freeze codes to prevent erroneous refunds are not always input on related Masterfile accounts

The IRS should enter a Transaction Code (TC) 130 on the taxpayer's related Masterfile account when a balance due account that exceeds a minimum tolerance amount is present on the ANMF. This code freezes the related Masterfile account to prevent the automatic issuance of incorrect refunds.

We reviewed the first 82 of 278 individual taxpayer cases with an ANMF liability from our random sample. As of September 30, 1997, about 66,000 of the 101,216 accounts on the ANMF were individual taxpayer accounts. Our review determined that:

The freeze was not present on 21 percent of the cases reviewed.

- The TC 130 freeze was not present as a result of the NMF liability in 17 of the 82 (21 percent) cases. A freeze was originally input on 3 of these 17 cases,

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but was reversed for unknown reasons, even though the NMF liability still exists.

- Three of the 17 taxpayers without a freeze on their accounts received erroneous refunds totaling \$12,136.
- It took an average of 42 days to record the freeze on 23 accounts with NMF assessments in 1996 and 1997. It took more than 30 days to record the freeze in 13 (57 percent) of the 23 cases.

Because of the age of these accounts, we could not determine why a freeze code was not input. However, our review of procedures and limited discussions identified the following conditions that could contribute to missing freeze codes and potential erroneous refunds:

Freeze codes may not be input on transfers of NMF accounts between service centers. When a NMF account is transferred between service centers, the receiving service center must input a new TC 130 into the Masterfile to establish a new freeze and override the TC 130 from the sending service center. This is necessary because the Masterfile issues a notice in the service center that input the freeze of a potential refund. IRS employees must review the notice and determine if the refund should be issued or if it should be applied to other delinquent accounts, including ANMF accounts. However, since the account was transferred, it is no longer on the ANMF of the service center that input the freeze. This could cause employees to reverse the freeze and allow the refund.

Of 82 accounts, we reviewed the 11 transferred accounts and found that 2 accounts did not have a freeze code. During the first 9 months of FY 1997, over 5,200 NMF taxpayer accounts were manually transferred among service centers. This volume of transfers and the manual processes required to establish and reestablish a freeze, increases the possibility that the freeze code will not be input and that erroneous refunds will be issued to taxpayers.

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Functions have different procedures for inputting the freeze.

Multiple functional responsibility may result in freeze codes not always being input. NMF assessments originate from several sources, including the Collection, Examination, Appeals, and Returns Processing functions. These functions have different procedures for inputting the freeze. For example, the Appeals function procedures say to input the freeze code themselves or prepare a Notice of Action for Entry on Master File (Form 3177) and send it to service center accounting.

Current IRS procedures for NMF Accounting require the NMF unit to prepare a Form 3177 to request the input of the freeze code when the first balance due notice is generated. The NMF unit then sends this form to the Service Center Collection Branch (SCCB), which is responsible for the input of the freeze code to the Masterfile. We did not conduct any tests to determine if the Forms 3177 were not prepared or were not input.

Some NMF units believe it is easier for them to input the freeze code.

Because freezes codes are not always input, the National Office issued an alert in January 1998, requiring NMF units to monitor accounts to ensure the freeze code was entered on the taxpayers' accounts. However, some NMF units believe it is easier to input the freeze code themselves, rather than rely on the SCCB or establish monitoring procedures. The NMF unit in at least one service center enters most of the freeze codes, including all cases transferred from other NMFs.

The issue of not having a freeze code on the Masterfile is not new.

The issue of not having a freeze code on the Masterfile is not new. Procedures have existed for some time, but were not used to their fullest potential on NMF accounts. In January 1992, the IRS issued procedures to improve the freeze code process. In February 1998, the NMF Study Group recommended a computer program to compare the ANMF with the Masterfile and to generate a listing of posted freeze codes on all appropriate Masterfile accounts.

We identified two computer programs that are both generated the 39th week of each year for other reasons: (1) a listing of all NMF accounts receivable, and (2) a listing of all freeze codes on the Masterfile. Using these

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existing programs may eliminate the need for a separate computer request.

Our analysis of the individual Form 1040 accounts with a balance due from these programs identified about 64,000 individual NMF balance due accounts over 60 days old, as of September 30, 1997, that should have had freeze codes. We matched these accounts to the list of accounts with freeze codes and identified about 21,700 NMF accounts (34 percent) without a related freeze code on the Masterfile.

Information returns (Form 1099-INT) for interest paid on NMF accounts are not always prepared

Forms 1099-INT were not issued on 27 percent of the cases reviewed.

The Internal Revenue Code (IRC), 26 U.S.C. § 6049 (1986) and service center procedures require the issuance of Form 1099-INT when interest over \$10 is paid to any person. These procedures also require tax examiners to manually identify these cases. Because this is a manual process, instances can occur where taxpayers are not notified that IRS has paid taxable interest that should be reported.

We reviewed 142 of 482 ANMF cases in which the IRS paid interest to individual taxpayers during the first 9 months of FY 1997. Forms 1099-INT were not issued in 38 cases (27 percent), although \$12,091 in interest was paid to taxpayers.

The number of cases requiring a Form 1099-INT is not large. We estimate that during the first 9 months of FY 1997, about 1,500 Forms 1099-INT should have been issued to taxpayers based on service center procedures. However, since this is a legal requirement, IRS should have adequate controls and procedures to ensure all required forms are issued.

Transfers of accounts from the Masterfile to and between NMFs are inefficient

During the first 10 months of FY 1997, about 8,600 accounts were transferred from the Masterfile to the NMF. About 13,000 ANMF taxpayer accounts were

Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service

Transferring accounts is a time-consuming and costly process.

also transferred among service centers. Workload redistribution resulted in 7,800 of these transfers.

Transferring accounts is a time-consuming and costly process. The transfer process requires the manual input of all transactions from a Masterfile or ANMF account to the new ANMF account. During the first 9 months of FY 1997, 12,800 transfers required the manual input of 186,000 transactions. Although we did not validate the study, in 1992, one service center estimated that it cost \$200 per account to transfer certain types of individual accounts from the Masterfile to the ANMF.

Recommendations

6. Revise or clarify procedures to input TC 130s when accounts are processed or transferred to the NMF. Two alternatives to the current process include:
 - Requiring the NMF function in the service center to input the TC 130 rather than forwarding the input form to the SCCB for input.
 - Requiring the function (Examination, Appeals, Collection, SCCB or Returns Processing) that establishes the NMF assessment to input the TC 130 and submit proof of the input before the account is processed to the NMF.
7. Using the existing computer listings of NMF Accounts Receivable and TC 130s generated the 39th week of each year, conduct an annual match to identify accounts without a “freeze.” This will give the IRS three months to update the Masterfile prior to the filing season.
8. Generate a list of ANMF transaction codes indicating the payment of interest and determine if a Form 1099-INT should be issued.

Management’s Response: A computer program request was submitted as a one time clean-up requesting that all open accounts on the ANMF be matched to the IMF account. If a match is found, a TC 130 will generate to

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the IMF account indicating a related ANMF account. Thereafter, a weekly NMF tape will be matched to the IMF for posting TC 130s to the IMF account. For BMF accounts, the originator remains responsible for the input of a TC 130. Also, the Submission Processing function coordinated with district offices and service centers to emphasize the necessity for the originator to either input directly or request input of the TC 130. In addition, the 1999 revision of the IRM will be updated to include procedures for TC 130s.

A computer program was developed to provide for the automatic posting of a freeze code to IMF accounts when an account is established on the ANMF. Due to limited resources that are needed for legislative and Year 2000 changes, and the extensive programming required, Forms and Submission Processing management elected not to provide for the automatic posting of freeze codes on BMF accounts. Instead, new procedures will require an annual review of all business accounts on the ANMF to verify a freeze is on the BMF account.

Procedures were added to the IRM for the NMF Database Administrator to identify taxpayer accounts where interest of \$10 or more was paid. A list will be provided to the Manual Refund Unit for preparation of Form 1099-INT.

Office of Audit Comment: We agree that it might require more programming to automatically post a freeze code on BMF accounts. However, we do not believe the IRS action to have the originator responsible to direct the input of the freeze code is adequate. First, it is because of the multiple number of initiators and functions currently involved that the freeze codes were not input. Second, any annual reviews, if conducted, may be too late to prevent the issuance of refunds. We continue to believe this process should be centralized. At a minimum, review procedures should be implemented to ensure the freeze code is input where required when the account is established on the ANMF.

Conclusion

There are 101,216 balance due accounts on the ANMF, with accounts receivable totaling over \$14 billion, including accrued interest and penalties. Until the IRS expedites changes to allow the processing of ANMF accounts on to the Masterfile, additional efforts are needed to more efficiently process NMF transactions and ensure accurate notices are issued to taxpayers.

The majority of the above issues will be eliminated when the IRS moves accounts to the Masterfile and consolidates the existing ANMFs. Until then, service center NMF units and the Customer Service function will be faced with the manual time-consuming processes now in place. Our recommendations should improve existing controls and procedures, reduce processing costs, and improve compliance.

Detailed Objectives, Scope, and Methodology

The overall objectives were to determine if Non-Masterfile (NMF) transactions are accurately recorded on the Automated Non-Masterfile (ANMF) and in the Internal Revenue Service (IRS) accounting system, and to determine if accounts are balanced and reconciled to the IRS accounting system. We also evaluated the necessity for the NMF.

We conducted sufficient validation tests to assess the reliability of the computer data obtained from the ANMF and Masterfile. We conclude the data are sufficiently reliable to meet our audit objectives, which were to:

- I. Determine if NMF transactions are accurately and timely recorded on the ANMF and in the IRS accounting system.
 - A. Selected a random attribute sample of 400 documents from the 190,000 documents processed on the ANMF during the first 9 months of Fiscal Year (FY) 1997. We reviewed the first 278 cases received with supporting documents to determine if the documents were accurately posted to the ANMF. Based on our sample criteria, we are 90 percent confident that the actual error rate is within plus or minus 5 percent of the sample error rate.
 - B. Reviewed the first 84 of the above 278 cases that required an accounting entry to determine if all transactions were accurately and timely posted to the appropriate ANMF and accounting system accounts. We did not receive sufficient supporting documentation on two cases to determine if the correct amount posted. In total, we did not receive sufficient supporting documentation on 18 cases to determine if entries were posted to the correct accounting codes.
 - C. Identified and evaluated problems associated with NMF processing. We discussed potential NMF processing issues and problems with National Office personnel.
 - D. Evaluated the accuracy of interest and penalty computations on the ANMF. We judgmentally selected 159 accounts from those reviewed in Objective I, Step A. We reviewed these cases for the accuracy of the interest and penalty calculations. However, we used a commercial software program used by some IRS functions and subsequently determined it did not calculate interest and failure to pay penalties in the same manner as Masterfile, and the results were, therefore, not accurate. We manually recalculated several cases representing examples of situations identified in which the ANMF system was miscalculating either the interest or penalties.

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1. Calculated interest and penalty amounts using IRS computer system command codes (COMPA and COMPAF) based on the following assumptions:
 - a) A 10-day grace period was allowed after the date of assessment (prior to December 31, 1996) before starting the failure to pay additional assessments calculation.
 - b) The maximum failure to pay penalty was a total of 25 percentage points rather than 25 percent of the assessed amount, if different.
 - c) The balance used to calculate interest did not include any accrued failure to pay penalty.
 2. Using the assumptions above, interest and penalties were calculated to the following dates:
 - a) The date of the accrued interest and penalty if the account had a balance due or had a zero balance.
 - b) The date of the account balance if the account had a credit (negative) balance.
- II. Evaluate the processes to ensure the ANMF and the accounting systems are accurate and balanced.
- A. Evaluated the role of the National Office in reconciling and balancing NMF accounts.
1. Discussed the National Office's role and responsibilities for the service centers' reconciling and balancing and their review of the Reconciliation of General Ledger Accounts (Form 3997).
 2. Obtained the most recent Form 3997 and attachments for each service center.
 - a) Reviewed Forms 3997 for items that have not been reconciled for more than one month.
 - b) Evaluated overage, unreconciled items.
- B. Reviewed and evaluated the reconciliation and balancing of NMF accounts in the service centers.
1. Discussed the reconciling and balancing of NMF accounts in the selected service centers.
 2. Selected the three most recent consecutive reconciliations and reviewed the supporting documentation to determine if all necessary adjustments were made.
- C. Determined if a Transaction Code 130 "freeze" is present on the Masterfile when an outstanding liability is present on the NMF.
1. Researched and reviewed the Internal Revenue Manual procedures.

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2. Selected 82 cases from our random sample of 278 where individual taxpayers had liabilities on the NMF and determined if:
 - a) The related Masterfile accounts contained the freeze code.
 - b) Freeze codes were posted when NMF accounts were transferred between service centers.
 - c) There were delays in recording the freeze codes after the ANMF liability was established.
 - d) Refunds were issued due to not recording the freeze codes.
- D. Determined if information returns for interest income (Forms 1099-INT) are issued when IRS pays interest on refunds.
 1. Analyzed a computer listing of Transaction Codes 770, 771 and 772 (credit interest and reversal of interest) processed on the ANMF during the first 9 months of FY 1997. This listing identified about 1,500 taxpayers that should be issued refunds. Of these, 482 were individual taxpayers.
 2. Selected a judgmental sample of 142 individual accounts with refunds issued to individual taxpayers from the Kansas City, Austin, and Fresno Service Centers.
 3. Compared the 142 cases to the service centers' records of Forms 1099-INT that were issued.
 4. Determined the procedures followed in each center to identify and issue Form 1099-INT to applicable NMF taxpayers.
- III. Evaluate the need for the IRS to maintain two systems (Masterfile and NMF) to record taxpayer transactions.
 - A. Analyzed ANMF account listings for the volume and types of returns and transactions that are processed.
 - B. Determined if transactions are recorded on the ANMF to ensure compliance with a legal or regulatory requirement, and evaluated whether certain transactions have to be processed on ANMF to ensure compliance with laws and regulations.
 - C. Evaluated the impact on processing efficiency of transferring files between the two systems—evaluated the time lag in assessing, refunding, or adjusting when an account has to be transferred to the ANMF from Masterfile.

Major Contributors to This Report

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National Director for Legislative Affairs CL:LA
Service Center Directors
Regional Commissioners

**Examples of Incorrect
Interest and Penalty Computations**

- The Automated Non-Masterfile (ANMF) system did not increase the failure to pay penalty from ½ percent to 1 percent after the date of the notice of intent to levy when monthly calculations were made to provide accounts receivable information.

On one account, an additional tax assessment of about \$27,600 was made in February 1997 and the “Notice of Intent to Levy” was issued in April. The ANMF system reflected a failure to pay accrued amount of about \$1,400 as of January 1998. The correct amount after increasing the penalty percentage to 1 percent should have been about \$2,500. The account was in Currently Not Collectible status.

- The ANMF system included an extra month’s failure to pay penalty in the accrued penalty computation.

The actual failure to pay penalty for one account with an additional tax assessment of about \$24,000 should have been about \$720. The ANMF reflected an accrued failure to pay amount of about \$840 that includes an additional month’s penalty of ½ percent on about \$24,000.

- The ANMF system did not compute penalties and interest correctly when certain payment transactions existed in the account prior to the assessment date that was recorded on the ANMF system or when two assessment transactions existed in the account.

An account was entered onto an ANMF with an assessment of about \$7,700 dated in June 1987. The account also had a credit of about \$1,870 for withheld taxes dated April 1987. The ANMF system computed the failure to pay penalty on the amount of the assessment without regard to the earlier credit. The penalty amount reflected on the ANMF system was approximately \$500 more than the maximum allowable. The taxpayer was subsequently relieved of her obligation to pay any of the penalty.

An account was entered onto an ANMF with an original tax assessment in the amount of about \$2,100. The account also had an additional tax assessment in the amount of about \$49,500. The failure to pay penalty reflected on the ANMF system included 25 percent of the combined amounts, but should have been computed only on the latter, additional tax assessment. This resulted in an additional penalty amount of approximately \$500.

Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service

This same account had credits in the account for estimated tax payments and overpayments carried over from the prior tax year. These credits had transaction dates several years prior to the additional tax assessment. The ANMF system reflected an accrued interest balance of about \$135,000. The correct accrued interest balance should have been about \$147,100.

The additional tax was subsequently abated and no penalty or interest was owed.

- Non-Masterfile (NMF) returns and other assessment documents may be received or prepared by other functions within the IRS. These documents can contain errors in the original interest and penalty assessments. However, the NMF unit does not review these assessments for accuracy prior to input to the ANMF. This results in subsequent incorrect interest and penalty computations.

A document was sent to a NMF unit requesting an assessment of about \$7,700. The correct amount that should have been assessed was about \$6,100. In December 1997, the ANMF system reflected an accrued interest balance of about \$760. The correct amount should have been about \$570.

- Accrued interest and penalties are not calculated or updated for taxpayer accounts on the ANMF if the balance is negative (a credit balance).

An account on an ANMF reflected an account credit balance of about \$3,600 in December 1997. The ANMF also reflected amounts for accrued interest and penalty of about \$6,000, with an effective date of August 1994, which had not been assessed. The actual accrued interest and penalty as of December 1997 should be about \$9,100 for an actual account balance of about \$5,500.

- Accrued interest and penalties will remain associated and displayed with accounts that no longer have any balance due on a particular ANMF either because the case was transferred to another ANMF or the assessed tax, interest, or penalties were either abated or paid.

A case on one ANMF was transferred to an ANMF in another service center. The account had a zero balance as of April 1997. The accrued interest and penalty, as of April 1997, of about \$2,000 was still associated with the account on the ANMF from which it was transferred as of January 1998.

In another case, the taxpayer made a payment that made the account a zero balance in October 1997. The accrued interest as of October 1997 of about \$230 was still associated with the account in January 1998.

Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service

- The ANMF erroneously calculated the failure to pay penalty to exceed a maximum “25 percent in the aggregate.”

Failure to pay penalties on the ANMF are calculated to 25 percent of the assessed dollar amount. If taxpayers make periodic payments, the sum of the monthly percentage amounts sometimes totals 25 percent ($\frac{1}{2}$ percent times 50 months if no “Notice of Intent to Levy” was issued) prior to totaling 25 percent of the assessed dollar amount.

One case on the ANMF reflected an accrued failure to pay penalty of about \$615 in February 1997. The tax assessment of about \$2,500 was made in September 1993 and a “Notice of Intent to Levy” was issued in January 1994. The taxpayer began making periodic payments in mid-1994. The 25 total percentage points was reached in early 1996 and the maximum penalty should have been about \$580. The ANMF system continued accruing the penalty since the dollar amount had not reached 25 percent of the original assessment or about \$615.

We requested and received an opinion from IRS’ Office of Chief Counsel that confirmed the maximum failure to pay penalty is based on the aggregate of monthly penalty rates totaling 25 percent.

Criteria: The Internal Revenue Code (IRC), 26 U.S.C. § 6601 (1986) requires interest to be paid on underpayments of any Internal Revenue tax unless specifically prohibited by law or mutual agreement. The IRC, 26 U.S.C § 6651 (1986) also provides for penalties if taxpayers fail to pay an amount assessed. The penalty for failure to pay amounts assessed starts accruing at $\frac{1}{2}$ percent per month on the net amount due. If the IRS issues the taxpayer a “Notice of Intent to Levy,” then the rate increases to 1 percent per month. The penalty should not exceed “25 percent in the aggregate.”

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Appendix V

Management's Response to the Draft Report



ASSISTANT COMMISSIONER
(FORMS AND SUBMISSION
PROCESSING)

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

March 30, 1999

OFFICE OF TREASURY
INSPECTOR GENERAL
RECEIVED
199904-46JLW QDH
1999 MAR 32 A 11: 03
FOR TAX ADMINISTRATION

MEMORANDUM FOR ACTING TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

THRU: John M. Dalrymple *John M. Dalrymple*
Chief Operations Officer

FROM: Brien T. Downing *Brien T. Downing*
Assistant Commissioner
(Forms and Submission Processing)

SUBJECT: Draft Internal Audit Report - Review of the Automated
Non-Master File (ANMF)

Thank you for the opportunity to review and comment on the draft report for the subject audit. We agree with the findings and the recommendations in the draft report. We are providing a status update of the corrective actions that have been taken relative to each of the recommendations.

Additionally, we would like to take this opportunity to emphasize that immediate action was taken to address the problems encountered by taxpayers with accounts on the NMF and the resulting issues that surfaced during the Senate Finance Committee hearings in September 1997. We conducted several reviews of the NMF and developed a comprehensive action plan detailing numerous actions we needed to take to improve our NMF system and related procedures, the majority of which have been implemented. However, due to the extensive programming requirements needed to support the remaining actions and the demands on our information systems staff to address the Century Date Change, additional changes will not be implemented until 2001.

Although we have taken immediate steps to implement what we consider to be short term fixes within the current NMF system, we face serious systems limitations due to outdated technology. The ultimate solution is the fundamental replacement of the entire master file system and until such time as this occurs, we will continue to be at risk for additional deficiencies to be identified. As you are aware, the current version of the Modernization Blueprint includes the scheduled migration of the mainline processing to a corporate database over the course of the next several years. Until such time as this is implemented, we will continue to monitor the NMF process to identify problems and take immediate steps to mitigate them.

Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service

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IDENTITY OF RECOMMENDATION/FINDING 1

Establish a working group of programmers, Non-Master File (NMF) personnel and other individuals knowledgeable on interest and penalties. This group should identify conditions where the ANMF system incorrectly calculates interest and penalties, integrate these issues with Year 2000 code development and testing, and:

- Make programming changes to correct the inaccuracies to the extent possible.
- Mark those ANMF accounts that require manual computations.

ASSESSMENT OF CAUSE(S)

The ANMF was designed with limited capabilities for calculation of penalty and interest accruals.

CORRECTIVE ACTION(S)

On June 1, 1998, an NMF Task Force was established to identify conditions where the ANMF system incorrectly calculates interest and penalties. The task force requested that the field offices identify and submit NMF penalty and interest problems for resolution.

The Request for Information Services (RIS) (TSF-8-0170) dated June 30, 1998, to correct the computation of penalty and interest on the ANMF system was implemented on January 4, 1999.

The new Exception Code M, to mark accounts requiring manual computation of interest and penalty, has been implemented.

Beginning January 1999, the Program Analysis System is reviewing work processed by the NMF function. This includes a review of Forms 4840 and 9774, NMF Notices, for accuracy of manual penalty and interest computations. In addition, management will be required to use a NMF "checklist" in their weekly reviews that includes the requirement to review the penalty and interest computation.

Submission Processing took additional measures to ensure accuracy in the computation of penalty and interest by conducting a Restricted Penalty & Interest training workshop for NMF technicians. The workshop was held during the week of September 14, 1998, and was conducted by penalty and interest specialists from Austin and Cincinnati Service Centers.

The newly created Service Center Account Specialist position includes in the duties to be performed, the coordination of quality assurance reviews with the Credit and Account Transfer Section to ensure the accuracy of the penalty and interest computation before the transfer of the account to the NMF.

IMPLEMENTATION DATE:

Completed – January 4, 1999

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RESPONSIBLE OFFICIAL(S)

Chief, Accounting Branch
National Director, Submission Processing
Assistant Commissioner (Forms and Submission Processing)

IDENTITY OF RECOMMENDATION/FINDING 2

Program the ANMF to accrue penalty and interest on credit balance cases or establish procedures to manually assess accrued penalty and interest when an account reaches a credit balance.

ASSESSMENT OF CAUSE(S)

The ANMF does not accrue penalty and interest when accounts are in a credit balance. The NMF unit performs a manual review to determine if a refund is due or additional penalties and interest should be assessed; this is a time-consuming process. The failure to timely work credit balance cases can result in loss of revenue and additional taxpayer burden, as the taxpayer may incur additional interest expenses or not receive a timely refund. Internal Revenue Manual (IRM) procedures were not being followed.

CORRECTIVE ACTIONS

The ANMF system generates a credit balance transcript at the following intervals:

- 1) First week the account is in credit balance
- 2) 26 cycles later if the account still has a credit balance
- 3) One year later if the account is in credit balance
- 4) Each week thereafter if the account continues to be in credit balance

IRM procedures have been changed to specifically require the assessment of all accrued penalty and interest on ANMF credit balance accounts and before establishment on the NMF database.

An additional enhancement, implemented March 12, 1999, generates a weekly Credit Balance Account listing, for use as a management tool by the NMF Unit Manager in monitoring inventory to ensure timely disposition of credit balance accounts.

Review of credit balance accounts will be a required component of National Office NMF program reviews.

IMPLEMENTATION DATE:

Completed – March 12, 1999

RESPONSIBLE OFFICIAL(S)

Chief, Accounting Branch
National Director, Submission Processing
Assistant Commissioner (Forms and Submission Processing)

Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service

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IDENTITY OF RECOMMENDATION/FINDING 3

Conduct a cleanup of existing accounts on the ANMF. This should include:

- A resolution of credit balance accounts to assess accrued interest and penalties, where appropriate.
- An analysis of old accounts to determine the validity of the assessment and the statute of limitations.

ASSESSMENT OF CAUSE(S)

Accounts have resided on ANMF for many years. The originators are not providing documentation for disposition of these accounts.

CORRECTIVE ACTION(S)

A memorandum dated November 5, 1998, was issued to inform the Service Center Directors that a review of all ANMF accounts that are currently less than 11 years old was to be conducted. The memorandum provided specified information for account resolution.

Internal Audit provided an extract, as of cycle 9839, of accounts currently 11 years in age and greater. Agreement was reached, between the Assistant Commissioner (Forms and Submission Processing) and the Offices of the Assistant Commissioners (Collection) and (Customer Service), in coordination with the Assistant Commissioner (Examination) and the National Director of Appeals, on the details for the review of the "aged" ANMF accounts.

Currently, a cross-functional task group of field personnel has been convened at the Atlanta Service Center to: 1) review a statistically valid sample of NMF accounts, 2) determine the workability of the decision tree check sheet and associated procedures developed for the review of the "aged cases," 3) provide a suggested structure to the review process, and 4) expand procedures as required.

A detailed review by a cross functional team of Collection, Examination, Appeals, NMF Accounting, and Service Center Collection Branch participants will be performed on all NMF accounts prior to issuance of the Taxpayer Bill Of Rights 2 (TBOR 2) annual notice of delinquency. The accounts previously reviewed by the service centers in response to the November 5, 1998 memorandum will also be included in this more detailed review.

IMPLEMENTATION DATE:

Proposed completion date for all NMF accounts – September 1, 1999

RESPONSIBLE OFFICIAL(S)

National Director, Submission Processing
Assistant Commissioner (Forms and Submission Processing)
Assistant Commissioner (Collection)

Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service

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IDENTITY OF RECOMMENDATION/FINDING 4

Conduct a computer match of addresses on the Individual (IMF) and Business (BMF) Master Files to addresses on the ANMF prior to issuing TBOR 2 notices, as recommended by the NMF Study Group. Timely update the ANMF with the most recent address.

ASSESSMENT OF CAUSE(S)

IRM procedures did not provide for address updates.

CORRECTIVE ACTION(S)

Two RISs (TSF-8-0257, and TSF-7-057) were submitted requesting a new process to generate an NMF Address Transcript when the master file address of an account with a related NMF account is changed. This will ensure that NMF addresses are updated to reflect the latest master file address prior to mailing notices. This action is directed to master file addresses updated January 1, 1999, and subsequent.

RIS (TSF-8-0173) was submitted to identify address updates input prior to January 1, 1999, for any master file entity module with an unreversed TC130. A NMF cleanup transcript will be generated to the NMF function for manual update of the NMF address. A subsequent BMF address update extract will be generated after the action to post the TC 130 (see Recommendation 7) is completed. Service Center Collection Branch will use the extract to input TC 130's to the affected accounts.

IMPLEMENTATION DATE:

Completed – February 1, 1999 (Master file addresses updated January 1, 1999, and subsequent)
Completed - March 1, 1999 (IMF and some BMF addresses updated prior to January 1, 1999)
Proposed – May 1999 (Second BMF extract for addresses updated prior to May 1, 1999)

RESPONSIBLE OFFICIAL(S)

Chief, Accounting Branch
National Director, Submission Processing
Assistant Commissioner (Forms and Submission Processing)

IDENTITY OF RECOMMENDATION/FINDING 5

Issue notices from the ANMF to comply with the TBOR 2 provision using the same criteria for issuing TBOR notices on master file accounts.

ASSESSMENT OF CAUSE(S)

TBOR 2 required that the Internal Revenue Service (IRS) send an annual reminder to taxpayers with delinquent tax accounts beginning in calendar year 1997. Submission Processing was originally scheduled to generate annual reminder notices on NMF accounts during the last quarter of calendar year 1997. However, several penalty and interest computation problems were identified, causing a delay in implementation.

Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service

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CORRECTIVE ACTION(S)

The IRS currently plans to begin generating the annual reminder notices during the second quarter of calendar year 1999, consistent with the master file criteria.

IMPLEMENTATION DATE:

TBOR 2 Notices – March 26, 1999 (ongoing)

RESPONSIBLE OFFICIAL(S)

Chief, Accounting Branch
National Director, Submission Processing
Assistant Commissioner (Forms and Submission Processing)

IDENTITY OF RECOMMENDATION/FINDING 6

Revise or clarify procedures to input TC 130 when accounts are established or transferred to the NMF.

ASSESSMENT OF CAUSE(S)

The ANMF is a system that requires manual input. It is the originating office's responsibility to input the TC 130. This action is not always done when necessary.

CORRECTIVE ACTION(S)

RIS TEF-8-008 requested that a tape containing all ANMF taxpayer entity information be processed during the End of Day runs and matched to the IMF account. If a match is found, a TC 130 will generate to the IMF account, indicating there is a related ANMF account.

This initial action will occur as a one-time cleanup on all open IMF accounts on the ANMF. Thereafter, a weekly NMF tape will be matched to the IMF for posting of new TC 130s to the IMF account. IDRS will be updated to display the NMF entity information. A TC 130 transcript will be provided to Collection to enable the update of their TC 130 database.

For BMF accounts, the originator still has the responsibility to prepare a Form 3177 directing input of the TC 130.

Submission Processing coordinated with district office and service center operations including Collection, Special Procedures, Appeals, Examination, and Adjustments to emphasize the necessity for the originator to either input directly or request input of TC 130. All functions have been requested to update affected IRMs with TC 130 procedures in their 1999 revision.

IMPLEMENTATION DATE:

January 29, 1999 (ongoing)

RESPONSIBLE OFFICIAL(S)

Chief, Accounting Branch
National Director, Submission Processing
Assistant Commissioner (Forms and Submission Processing)

Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service

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IDENTITY OF RECOMMENDATION/FINDING 7

Using the existing computer extracts of NMF Accounts Receivable and TC 130s, conduct an annual match, as of cycle 39, to identify accounts without a "V" freeze.

ASSESSMENT OF CAUSE(S)

The NMF is a system that requires manual input. The originator does not always input a TC 130 when necessary.

CORRECTIVE ACTION(S)

RIS TEF-8-008 was submitted to eliminate the need for NMF technicians to manually compare the two IMF extracts. The RIS provides for the systemic posting of TC 130s to IMF accounts. (Please refer to the response to Recommendation 6 above.)

Due to the limited resources which are needed for legislative and Y2K changes, and the extensive programming required to provide the same systemic solution for the low volume of BMF accounts on the NMF, we are instead providing procedures for use beginning April 1, 1999. The procedures will instruct the NMF Database Administrators to produce a database query listing of BMF modules to be issued to the Service Center Collection Branch (SCCB) on an annual schedule for verification of the TC 130 on related BMF accounts. If the TC 130 is not present on the BMF account, SCCB will input the TC 130.

IMPLEMENTATION DATE(S):

IMF - January 29, 1999

BMF - April 1, 1999

RESPONSIBLE OFFICIAL(S)

Chief, Accounting Branch

National Director, Submission Processing

Assistant Commissioner (Forms and Submission Processing)

Assistant Commissioner (Customer Service)

IDENTITY OF RECOMMENDATION/FINDING 8

Generate a list of ANMF transaction codes indicating the payment of interest in order to determine if a Form 1099 should be issued.

ASSESSMENT OF CAUSE(S)

Forms 1099 for interest paid on NMF accounts are not always prepared by the Manual Refund functions.

CORRECTIVE ACTION(S)

Procedures have been added to IRM 3.17.46.0 instructing the NMF Database Administrator to identify taxpayer accounts where refund interest for \$10 or more was paid. The list will be forwarded to the Manual Refund Unit for preparation of Form 1099-INT. Instructions have been added to IRM 3.17.79 to cover this new procedure.

Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service

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IMPLEMENTATION DATE:
January 5, 1999

RESPONSIBLE OFFICIAL(S)
Chief, Accounting Branch
National Director, Submission Processing
Assistant Commissioner (Forms and Submission Processing)

We will respond to the issue identified in the last two paragraphs on page six of the draft report in a separate memorandum. If you have any questions or require additional information, please give me a call or a member of your staff may call Cris Balzereit at (202) 622-7055.